

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Date: NOV 30 2001

Contact Person:

ID Number:

Telephone Number:

Employer Identification Number:

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

You are formed under the laws of the State of [REDACTED] as an irrevocable trust. Your trust document provides that you are organized and operated exclusively to support or benefit, as defined by section 1.509(a)-4(b)(1) of the Income Tax Regulations, one or more publicly supported organizations. Notwithstanding any other provision hereof, you shall not conduct or carry on any activities not permitted to be conducted or carried on by an organization which is tax exempt or by an organization donations to which are deductible from taxable income to the extent allowed by the provisions of the Code.

[REDACTED] is your donor and also your trustee. [REDACTED] is also a disqualified person since he contributes a substantial amount of your funds. As your trustee, [REDACTED] may receive donations from the donors, or from any other source in cash and may accept donations from the donors, or from any other source in property other than cash that is acceptable to him. Your principal financial support will be from contributions by [REDACTED] and not from fundraising activities.

Your trust document requires the trustee to distribute [REDACTED] percent of your net income to [REDACTED] ([REDACTED]) to help [REDACTED] perform its functions and carry out its purposes. Each year your board shall meet with the board of [REDACTED] to determine the use of such distributions. Prior to making any donation or distribution, you shall obtain written confirmation that [REDACTED] is currently recognized as a tax exempt

organization under section 501(c)(3) of the Code. You are also required to give periodic accountings (at least annually) to [REDACTED].

In addition to the distribution to be made to [REDACTED] each year, your trustee shall distribute a total of [REDACTED] percent of your net income to one or more of the 501(c)(3) tax exempt organizations listed on Schedule A or to [REDACTED] as is directed by your board in writing signed by at least three members. There are about [REDACTED] organizations on Schedule A. If at any time [REDACTED] is not an organization to which distributions can be made by an organization described in section 509(a)(3) of the Code, then your board shall select an organization from those listed on Schedule A and such organization shall be entitled to all of the rights and benefits as are herein designated for [REDACTED].

Your trustee may determine, in his sole and complete discretion, that the amount of funds in your trust is too small to economically administer, and distribute the funds outright and free of trust to such organization or organizations as described in section 170(c)(2) of the Code.

However, your dissolution clause provides that if you do not obtain tax exempt status under sections 501(c)(3) and 509(a)(3) of the Code, your assets shall go to the Simonsen family as a contingent remainder.

Your trustee shall have the power to retain any asset originally or later contributed to the trust estate whether or not such asset be of a character permissible for investment by fiduciaries; to retain and purchase assets notwithstanding the lack of diversification of the trust assets; to retain, purchase, sell or exchange any and all stocks, bonds, notes or other securities or any variety of real or personal property including stocks or interest in investments or mutual funds; to change the situs of the trust and of any property which is part of the trust to any place in the United States of America or any other country; and to make distributions of principal or income in kind. However, any of the powers, duties or authority given to the trustee may be exercised and is under the control of and by the board which shall be evidenced by a writing given to the trustee and signed by at least three members of the board. The board may remove your trustee as long as the trustee is given written notice of such removal signed by a member of the [REDACTED] family and one other board member.

Your board shall consist of five members. [REDACTED] or its designated agent has appointed [REDACTED] to your board. Two of your board members shall be from the class consisting of [REDACTED] and [REDACTED] and each of their descendants (the [REDACTED] Family). The other members of the board shall be appointed by a majority vote by the remaining members of your board. Your initial remaining board members are [REDACTED] and [REDACTED]. [REDACTED] is a managing member of [REDACTED]. [REDACTED] is also a licensed real

estate agent with [REDACTED] and their activities are limited to owning properties. [REDACTED] is the daughter and business associate of [REDACTED]. [REDACTED] is a retired teacher who lives in [REDACTED] and is involved in farming and ranching. [REDACTED] is the brother of [REDACTED], the attorney who is assisting you in applying for exempt status under section 501(c)(3) of the Code. The minutes from your first meeting state that the above named persons are board members for life. Your trust document provides that your membership of your board shall be such that your donors or other disqualified persons shall not control your board.

You submitted an unsigned amendment to the trust document that provides that three of your board members will be appointed by [REDACTED]. According to this amendment, [REDACTED] appoints [REDACTED], [REDACTED] and [REDACTED] to your board.

The current board members of [REDACTED] are [REDACTED], [REDACTED], and [REDACTED]. [REDACTED] is [REDACTED]'s spouse. [REDACTED] is an attorney in private practice and is a brother to [REDACTED]. [REDACTED] represents the donor as his attorney. You have provided no information regarding the actual total annual income of [REDACTED] for years [REDACTED] and [REDACTED].

You state that your primary asset is the conservation easement previously owned by your donors through [REDACTED]. The easement is against approximately [REDACTED] mountain acres in [REDACTED] known as [REDACTED]. [REDACTED] is a property held by [REDACTED] and owned by your donors. You have no cash and no publicly traded stock. In an appraisal of the value of the easement prepared for [REDACTED] the easement was valued at \$[REDACTED]. Although you state that at least [REDACTED] percent of your net income will be given to [REDACTED], you have not sold the easement nor submitted information indicating that you have earned and distributed net income. Aside from your initial meetings and the meeting regarding the application process, you have not conducted any activities. You state that other assets of significant value will be contributed after all organizational matters have been completed.

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for, among others, charitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations provides, in part, that the term "charitable" is used in its generally accepted legal sense.

Section 1.501(c)(3)-1(a)(1) of the regulations provides that in order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized exclusively for any of the purposes specified in section 501(c)(3) unless it serves public rather than private interests. Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(c)(2) of the regulations provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Section 1.501(a)-1(c) of the regulations provides that private shareholders or individuals are defined as persons having a personal and private interest in the activities of an organization.

In Better Business Bureau v. United States, 326 U.S. 279 (1945), the Supreme Court stated that the presence of a single nonexempt purpose, if substantial in nature, will preclude exemption under section 501(c)(3) of the Code, regardless of the number or importance of statutorily exempt purposes.

Operating for the benefit of private parties constitutes a substantial nonexempt purpose. Old Dominion Box Col v. United States, 477 F. 2d 340 (4th Cir. 1973)(, cert. Denied 413 U.S. 910 (1973).

Leon A. Beeghly v. Commissioner, 35 T.C. 490 (1960), provided that where an exempt organization engages in a transaction with a related interest and there is a purpose to benefit the private interest rather than the organization, exemption may be lost even though the transaction ultimately proves profitable for the exempt organization.

[REDACTED]

In P.L.L. Scholarship v. Commissioner, 82 T.C. (1984), an organization operated bingo at a bar for the avowed purpose of raising money for scholarships. The board included the bar owners, the bar's accountant, also a director of the bar, as well as two players. The board was self-perpetuating. The Court reasoned that since the bar owners controlled the organization and appointed the organization's directors, the activities of the organization could be used to the advantage of the bar owners. The organization claimed that it was independent because there was separate accounting and no payments were going to the bar. The Court was not persuaded.

A realistic look at the operations of these two entities, however, shows that the activities of the taxpayer and the Pastime Lounge were so interrelated as to be functionally inseparable. Separate accountings of receipts and disbursements do not change that fact.

The Court went on to conclude that the organization had a substantial nonexempt purpose.

In American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), the Tax Court was called on to decide whether benefits to third parties, who were not members, would prevent the organization from being recognized as an exempt organization within the meaning of section 501(c)(3) of the Code. The Court concluded that the organization could not confer substantial benefits on disinterested persons and still serve public purposes within the meaning of section 1.501(c)(3)-1(d)(1)(ii) of the regulations.

Secondary benefits which advance a substantial purpose cannot be construed as incidental to the organization's exempt educational purpose. Indeed, such a construction would cloud the focus of the operational test, which probes to ascertain the purpose towards which an organization's activities are directed and not the nature of the activities themselves.

In International Postgraduate Medical Foundation v. Commissioner, TCM 1989-36 (1989), the Tax Court considered the qualification for exemption under section 501(c)(3) of the Code of a non-profit corporation that conducted continuing medical education tours. The petitioner had three trustees. Mr. Helin, who was a shareholder and the president of H & C Tours, a for-profit travel agency. Mr. Regan, an attorney, and a third director who was ill and did not participate. Mr. Helin served as executive director. The petitioner shared offices with H & C Tours. The petitioner used H & C Tours exclusively for all travel arrangements. The petitioner's contract with H & C Tours permitted it to acquire competitive bids, but provided that H & C Tours would always get

the bid if it was within 2.5%. There is no evidence that the petitioner ever sought a competitive bid. The Court found that a substantial purpose of the petitioner was benefiting the for-profit travel agency. It concluded that:

When a for-profit organization benefits substantially from the manner in which the activities of a related organization are carried on, the latter organization is not operated exclusively for exempt purposes within the meaning of section 501(c)(3) even if it furthers other exempt purposes.

We find that a substantial purpose of petitioner's operations was to increase the income of H & C Tours. H & C Tours benefits from the distribution and production of brochures which solicit customers for tours arranged by H & C Tours. Approximately 90 percent of petitioner's total revenue for 1977 was expended on production and distribution of brochures. The terms of the Travel Service and Administrative Support Agreement further insured that H & C Tours would substantially benefit from petitioner's operations. Petitioner did not solicit competitive bids from any travel agency other than H & C Tours.

In *KJ's Fund Raisers, Inc. v. Commissioner*, T. C. Memo 1997-424 (1997), affirmed 82 AFTR 7092(1998), the tax Court found that another gaming organization was not exempt. While the organization raised money for charitable purposes, it also operated for the substantial benefit of private interests. The organization's founders, Kristine Hurd and James Gould, were the sole owners of a bar, KJ's Place. The organization, through the owners and employees of KJ's Place, sold lottery tickets exclusively at KJ's Place during regular business hours. While in KJ's Place, the lottery ticket purchasers were sold beverages from the bar. The initial directors were Hurd, Gould, and a related individual. The initial board was replaced several times until Hurd and Gould were no longer on the board. At all times Hurd and Gould were the organization's officers. Salaries had been paid to Hurd and Gould and rent had been paid to KJ's Place. The organization maintained that the fact that salaries and rent were no longer paid in this fashion indicated the independence of the board. The court took another view.

To be described in section 501(c)(3) of the Code, an organization must be organized and operated exclusively for exempt purposes. An organization will be regarded as operated exclusively for exempt purposes only if it engages primarily in activities which accomplish those exempt purposes. An organization does not operate exclusively for exempt purposes if more than an insubstantial part of its activities do not further exempt purposes. Section 1.501(c)(3)-1(c)(1) of the regulations. Also, see,

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Better Business Bureau v. United States, supra.

In Founding Church of Scientology v. United States, 412 F.2d 1197 (Ct.Cl.1969), cert. denied, 397 U.S. 1009 (1970), the court upheld a denial of 501(c)(3) exemption on the ground that part of the organization's net earnings inured to the benefit of the founder and his family. The court stated that net earnings may inure in ways other than by the actual distribution of dividends or payment of excessive salaries. The court noted that the founder received substantial amounts designated as fees, commissions, royalties, compensation for services, loans, payment of expenses incurred in connection with services, repayment of loans, use of an automobile, and use of a residence; that the founder's income steadily increased; that the founder and his wife were two of the three board members; that the family members received payments designated as rents, loans, reimbursement of expenses, and salaries; that the loans' purposes and terms were unexplained; and that the purposes of the reimbursements of expenses were also unclear. The court stated that the very existence of a private source of loan credit from an organization's earnings may itself amount to inurement; that Congress when conditioning the exemption upon "no part" of the earnings being of benefit to a private individual, specifically intended that the amount or extent of benefit could not be the determining factor; and that if in fact a loan or other payment in addition to salary is a disguised distribution or benefit from the net earnings, the character of the payment is not changed by the fact that the recipient's salary, if increased by the amount of the distribution or benefit, would still have been reasonable.

An organization is not operated exclusively for exempt purposes unless it serves a public rather than a private interest. An organization must establish that it does not operate for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled directly or indirectly, by such private interests. Section 1.501(c)(3)(d)(1) of the regulations.

An exempt charity has the responsibility to use its income and assets primarily to further its charitable purposes. If a nonprofit organization allows a private party to control substantially all of the organization's activities or assets, e.g., if a private party has powers that enable it to control the flow of income or the disposition of assets owned by the charitable organization, it will violate the private benefit test of section 1.501(c)(3)-1(c)(1) of the regulations. In other words, a for-profit entity's ability to exert significant control over the operations of a nonprofit organization for the benefit of the for-profit entity will disqualify the nonprofit organization from exempt status, even if the for-profit's control is achieved indirectly through contractual arrangements and payments to the for-profit are reasonable. See, est of Hawaii v. Commissioner, supra; and, United Cancer Council, Inc. v. Commissioner, supra.

Further, you do not have a community board, as ██████████, your founder and

owner of [REDACTED] who will benefit from you, chooses the members of the board. The board members he has chosen are the same individuals who service on the board of [REDACTED] and otherwise control it and also serve on your board as your officers. Due to the lack of arm's length relationship between your founder, board, [REDACTED]'s board and perhaps the [REDACTED], there is an opportunity for abuse of tax exemption. You do not have a community based board of directors that will supervise your program, set compensation, and insure that you are operated for charitable purposes and not for the private benefit of individuals or [REDACTED] or the [REDACTED]. Without these safeguards, you could be operated for the substantial nonexempt purposes of benefiting the private interests of your founder and other persons in charge, and a for-profit entity, prohibited under section 1.501(c)(3)-1(d)(1)(ii) of the regulations. Regardless of the activities that will further your exempt purposes, as the Supreme Court noted in Better Business Bureau v. United States, a single nonexempt purpose, if substantial in nature, will destroy exemption.

Without more information about your net income and your investments, we cannot conclude that you are operated in a charitable manner.

Section 5.01 of Rev. Proc. 90-27, 1990-1 C.B. 514, provides that a determination letter will be issued to an organization only when its application and supporting documents establish that it meets the particular requirements of the section under which exemption is claimed. Section 5.02 of Rev. Proc. 90-27 provides that exempt status will be recognized in advance of operations only when the proposed operations can be described in sufficient detail to permit a conclusion that the organization will clearly meet the particular requirements of the section under which exemption is claimed. The organization must fully describe the activities in which it expects to engage (including the standards, criteria, procedures or other means adopted or planned for carrying out the activities), the anticipated sources of receipts, and the nature of the contemplated expenditures.

The information contained in your application and supporting documents fails to describe your operations with sufficient particularity so as to establish that you meet the requirements for exemption under section 501(c)(3) of the Internal Revenue Code.

Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code and you must file federal income tax returns.

Contributions to you are not deductible under section 170 of the Code.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views to this office, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after

[REDACTED]

your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgement or decree under this section shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and a copy will be forwarded to the Ohio Tax Exempt and Government Entities (TE/GE) office. Thereafter, any questions about your federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201. The appropriate State Officials will be notified of this action in accordance with Code section 6104(c).

When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

Internal Revenue Service

[REDACTED]
1111 Constitution Ave, N.W.
Washington, D.C. 20224

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

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[REDACTED]
Manager, Exempt Organizations
Technical Group 4